AOG

ANNUAL REPORT 1997

Alberta Oil and Gas

CORPORATE PROFILE

Alberta Oil and Gas Petroleum Corp.("AOG"), (formerly Alberta Oil and Gas Limited) is a Calgary based oil and gas exploration and production company listed on The Alberta Stock Exchange under the symbol "AOC". The Company operates exclusively in the Western Canadian Sedimentary Basin. The Company underwent a significant reorganization during 1997, a transition intended to establish and grow Canada's pre-eminent junior oil and gas company. A new identity will be manifested through a new technical team, a new capital structure and a new name - EDGE ENERGY INC.

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The Annual and Special Shareholders' Meeting of Alberta Oil and Gas Petroleum Corp. will be held in the McDougall Room at the 400 Club, 710 - 4th Avenue SW, Calgary, Alberta on April 9th, 1998 at 9:00 a.m.

November 28, 1997

- A preliminary prospectus to raise new equity was filed by AOG with the British Columbia, Alberta, Saskatchewan, Ontario and Quebec securities commissions.

December 15, 1997

- AOG announced the termination of its equity financing upon the advice of the agents for the offering, that they could not successfully market any size offering given the current financial standing of AOG and the prevailing market conditions.

- In the same press release, AOG announced an updated December 1, 1997 McDaniel & Associates Consultants Ltd. reserve report which reduced AOG's total reserves due to poor production test results from two recently drilled wells.

- These events compelled AOG to consider other alternatives to reduce debt and enhance shareholder value.

THE RESULT

December 31, 1997

- AOG announced the approval of an Arrangement Agreement with Cairo Energy Inc., 763375 Alberta Ltd. and 763387 Alberta Ltd.

- The arrangement provides AOG with greatly enhanced operational, management and financial resources. In particular, the arrangement will allow AOG to reduce its debt by approximately $9 million and to meet the financial covenants under its banking arrangement.

March, 1998

- The Arrangement Agreement was amended to include 771988 Alberta Ltd., a company established to raise approximately $10 million, subject to closing the Arrangement Agreement. Inclusion of 771988 Alberta Ltd. in the arrangement will leave AOG essentially debt free and well positioned to accelerate its capital program and growth.

- The Arrangement Agreement will be communicated to shareholders by way of an Information Circular to be mailed in conjunction with the Annual Report on March 11, 1998, for approval by shareholders at the April 9, 1998 Annual and Special Shareholders' Meeting.

THE FACTS

Selected Pro Forma Consolidated Financial Information

The following table sets out certain consolidated financial information for AOG as at December 31, 1997, and for AOG on a pro forma basis as at December 31, 1997, after giving effect to the Arrangement and certain other adjustments.

	AOG	Pro Forma Consolidated
	(audited)	(unaudited)
Current assets	3,911	4,015
Deferred charges	133	133
Capital assets	19,611	28,204
Total assets	23,655	32,352
Current liabilities	21,664	4,085
Long-term debt	3,167	3,167
Provision for site restoration	972	1,016
Total liabilities	25,803	8,268
Shareholders' equity (deficiency)	(2,148)	24,084
	23,655	32,352

Subsequent to the Arrangement, AOG will have approximately 16 million shares outstanding.

Selected Pro Forma Consolidated Operational Information

The following table sets out certain operational information for AOG, Cairo and 763375 Alberta Ltd. as at December 31, 1997 and for AOG on a pro forma basis as at December 31, 1997 after giving effect to the Arrangement and certain other adjustments.

	AOG	Cairo	763375 Alberta Ltd.	Pro Forma Consolidated
Undeveloped land holdings (net acres in 000's)	85.9	-	24.3	110.2
Production (before royalties)				
Natural gas (Mcf/d)	8,075	1,311	264	9,650
Crude oil and NGLs (Bbls/d)	563	71	3	637
Total proved reserves				
Natural gas (Bcf)	19.7	3.9	1.4	25.0
Crude oil and NGLs (Mbbls)	1,680.7	152.4	39.1	1,872.2
Total proved plus unrisked probable reserves				
Natural gas (Bcf)	25.0	4.5	1.9	31.4
Crude oil and NGLs (Mbbls)	2,242.1	190.5	63.2	2,495.8

THE VISION

- Establish and aggressively grow Canada's pre-eminent junior oil and gas company
- Consistently achieve a high rate of return and create shareholder value

THE STRATEGIES

- Create and maintain a competitive edge through retaining and motivating people with proven track records – tie compensation directly to creation of shareholder value
- Utilize extensive relationships to aggressively acquire and grow a high quality core asset base
- Acquire and exploit under-managed and under-capitalized assets
- Establish and dominate core areas of operation based on the technical expertise of the team and the availability of large acreage positions
- Control operations through operatorship, high working interest and ownership of facilities
- Focus exploitation and exploration, supported by detailed technical analysis, on core areas
- Explore new ideas

THE TEAM

- As outlined in the Information Circular, the Company has been dramatically reorganized. A new management and technical team with proven track records and significant personal shareholdings in the new company has been put in place.

THE NAME

- Effective April 15, 1998, to recognize the business combination as a new company, AOG will be renamed **EDGE ENERGY INC**.

We look forward to delivering exciting new results to all of the shareholders of **EDGE ENERGY INC.**

Yours truly,

Alberta Oil and Gas Petroleum Corp.

Ken McNeill
Chief Executive Officer

OPERATIONS REVIEW

RESERVES	Oil & NGLs MSTB	Gas Mmcf	Total MBOE	Present Worth of Future Net Production Revenue ($000's) 10%	15%	20%
Proved producing reserves	1,555	14,082	2,963	24,427	20,301	17,417
Proved non-producing reserves	7	5,598	567	4,341	3,538	2,950
Proved undeveloped reserves	119	16	120	774	564	429
ARTC	-	-	-	991	859	762
Total proved reserves	1,681	19,696	3,650	30,533	25,262	21,558
Risked probable reserves (1)	280	2,676	548	3,412	2,380	1,776
ARTC	-	-	-	140	113	94
Total reserves	1,961	22,372	4,198	34,085	27,755	23,428

Note:(1) Probable reserve volumes and values have been reduced by 50% to allow for risk.

PRODUCTION	1993	1994	1995	1996	1997	1997 Q1	1997 Q2(1)	1997 Q3(1)	1997 Q4(1)
Crude oil (BOPD)	409	791	901	748	551	636	550	511	500
NGLs (Bbls/d))	30	39	59	72	59	83	52	50	64
Total liquids (Bbls/d)	439	830	960	820	610	719	602	561	564
Natural gas (Mmcf/d)	1.6	3.5	8.1	10.1	9.2	10.5	10.7	10.1	7.7

Note:(1) Production reflects Q1 sale of Wildmere, Q4 sale of a minor property package and excludes 1.9 Mmcf/d reduction in Q4 for cumulative prior year adjustment on non- operated well group.

ACREAGE SUMMARY (000 acres) as at December 31	Developed Gross	Developed Net	Undeveloped Gross	Undeveloped Net	Total Gross	Total Net
1993	74.7	19.1	47.2	13.5	121.9	32.6
1994	207.0	51.8	178.3	55.4	385.3	107.2
1995	404.3	83.4	297.5	95.3	701.8	178.7
1996	382.6	80.9	273.3	90.1	655.9	171.0
1997	245.0	65.7	242.0	85.9	487.0	151.6

MANAGEMENT'S DISCUSSION AND ANALYSIS

Netbacks	1997		1996		1995	
	$000's	$/BOE	$000's	$/BOE	$000's	$/BOE
Gross revenue	12,072	21.56	14,161	21.23	11,573	17.93
Hedging costs	(458)	(0.82)	(2,112)	(3.17)	(13)	(0.02)
Gross after hedges	11,614	20.74	12,049	18.06	11,560	17.91
Royalties	(2,121)	(3.78)	(2,327)	(3.49)	(1,989)	(3.08)
Operating costs	(3,381)	(6.04)	(3,797)	(5.69)	(2,861)	(4.43)
Operating income	6,112	10.92	5,925	8.88	6,710	10.40
G&A expenses	(2,053)	(3.67)	(2,680)	(4.01)	(2,157)	(3.34)
Reorganization costs	(1,305)	(2.33)	-	-	-	-
Interest expense	(1,187)	(2.12)	(1,733)	(2.60)	(1,494)	(2.32)
Cash netback	1,567	2.80	1,512	2.27	3,059	4.74
DD&A	(3,853)	(6.88)	(4,405)	(6.61)	(4,057)	(6.29)
Ceiling test write-down	(9,000)	(16.07)	-	-	(6,000)	(9.30)
Capital taxes	(30)	(0.05)	(62)	(0.09)	(127)	(0.20)
Earnings (loss)	(11,316)	(20.20)	(2,955)	(4.43)	(7,125)	(11.05)

Gross revenue decreased by $2,089,000 (15%) from 1996 due to a 16% reduction in production (from 1,827 BOE/D to 1,534 BOE/D) offsetting a 1% increase in average commodity prices (consisting of a $0.32/Mcf improvement in the average gas price and a $2.53/Bbl reduction in the average oil price). The production decrease was attributable to property sales aggregating 275 BOE/D during the year, together with natural production declines not fully offset by replacement efforts. 1997 fourth quarter results were also reduced by a payout adjustment on certain non-operated properties affecting over three years of production aggregating about $100,000 of operating income and 47 BOE/D.

Operating costs are net of processing recoveries, which totaled $664,000 for 1997, $648,000 for 1996 and $397,000 for 1995 ($1.19/BOE, $0.97/BOE and $0.62/BOE respectively). Higher unit operating costs in 1997 reflect both the extreme 1997 winter conditions and the impact of fixed costs over a lower production base.

General and administrative costs decreased in the latter part of 1997 reflecting results of the significant restructuring undergone by the Company during the year which resulted in a lower staff count and reduced overhead costs. **Restructuring costs** include all costs of buying out the former corporate management agreement and related restructuring costs including legal fees and employment contract payments. Included in general G&A costs is approximately $100,000 for costs relating to the unsuccessful public offering in the fourth quarter. The Company anticipates its G&A costs per BOE to reduce in 1998 due to the lower staff count and lower base salaries.

The 1997 **ceiling test adjustment** consists of a $1.8 million write-down at September 30, 1997 and an additional $7.2 million write-down at year-end. The year-end adjustment is based on current prices in early 1998 of $17.00/Bbl US WTI and a company net gas price of $1.85/Mcf, together with a US exchange rate of 1.45 Cdn$/US$ and a prime lending rate of 6%.

AUDITORS' REPORT TO SHAREHOLDERS

We have audited the balance sheets of Alberta Oil and Gas Petroleum Corp. (formerly Alberta Oil and Gas Limited) as at December 31, 1997 and 1996 and the statements of operations and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended, in accordance with generally accepted accounting principles.

KPMG

Chartered Accountants – Calgary, Canada
February 20, 1998, except with respect to Notes 6 and 11 which are as of March 4, 1998

BALANCE SHEETS

As at December 31

ASSETS	1997	1996
Current assets:		
Cash	$ 63,968	$ 89,903
Accounts receivable	3,847,103	3,792,166
	3,911,071	3,882,069
Deferred charges (note 3)	132,974	144,669
Capital assets (note 4)	19,611,341	32,222,394
	$ 23,655,386	$ 36,249,132

LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current liabilities:		
Accounts payable and accrued liabilities	$ 7,112,221	$ 7,484,451
Current portion of long-term debt (note 5)	14,552,033	2,125,981
	21,664,254	9,610,432
Long-term debt (note 5)	3,167,381	16,607,407
Deferred future abandonment and restoration costs (note 4)	971,508	831,052
Shareholder's equity (deficiency):		
Share capital (note 6)	5,458,701	21,892,811
Deficit	(7,606,458)	(12,692,570)
	(2,147,757)	9,200,241
Going concern (note 2)		
Commitments and contingency (notes 5 and 10)		
Subsequent events (notes 6 and 11)		
	$ 23,655,386	$ 36,249,132

See accompanying notes to the financial statements

Approved by the Board:

Kenneth L. McNeill, Director

Mark D. Behrman, Director

STATEMENTS OF OPERATIONS AND DEFICIT

For the years ended December 31

REVENUES	1997	1996
Gas	$ 6,848,826	$ 5,435,963
Oil	4,765,207	6,612,643
	11,614,033	12,048,606
Net royalties	(2,120,604)	(2,327,118)
	9,493,429	9,721,488

EXPENSES		
Depletion, depreciation and amortization (note 4)	12,480,019	3,938,089
Operating	3,381,192	3,796,895
General and administrative (note 8)	2,052,899	2,679,744
Reorganization (note 9)	1,305,156	-
Interest	1,186,622	1,732,557
Provision for abandonment and restoration	373,246	466,919
	20,779,134	12,614,204
Loss before taxes	(11,285,705)	(2,892,716)
Current income taxes (note 7)	(30,000)	(62,300)
Net loss	(11,315,705)	(2,955,016)
Deficit, beginning of year	(12,692,570)	(9,737,554)
Reduction in stated capital (note 6)	16,401,817	-
Deficit, end of year	$ (7,606,458)	$ (12,692,570)
Net loss per share (note 6)	$ (1.25)	$ (0.34)

See accompanying notes to the financial statements

STATEMENTS OF CHANGES IN FINANCIAL POSITION

For the years ended December 31

CASH PROVIDED BY (USED IN) OPERATIONS	1997	1996
Net loss	$ (11,315,705)	$ (2,955,016)
Charges not affecting cash		
Depletion, depreciation and amortization	12,480,019	3,938,089
Provision for abandonment and restoration	373,246	466,919
Funds from operations	1,537,560	1,449,992
Changes in non-cash working capital relating to operations	(435,746)	2,123,842
	1,101,814	3,573,834
FINANCING ACTIVITIES		
Change in long-term debt	(1,013,974)	(1,012,542)
Issue (repurchase) of Common Shares	(32,293)	1,475,103
	(1,046,267)	462,561
INVESTING ACTIVITIES		
Proceeds on the sale of capital assets	8,445,842	1,863,930
Acquisition of capital assets	(8,279,348)	(6,815,842)
Abandonment and restoration costs	(232,790)	(246,925)
Deferred charges	(23,765)	(152,298)
Changes in non-cash working capital relating to investing	8,579	1,244,571
	(81,482)	(4,106,564)
CASH		
Decrease in cash	(25,935)	(70,169)
Cash, beginning of year	89,903	160,072
Cash, end of year	$ 63,968	$ 89,903
Funds from operations per share	$ 0.17	$ 0.17

See accompanying notes to the financial statements

Notes to Financial Statements

Years ended December 31, 1997 and 1996

1. Summary of significant accounting policies:

(a) Petroleum and natural gas properties:

Alberta Oil and Gas Petroleum Corp. (the "Corporation") follows the full cost method of accounting in accordance with the guidelines issued by the Canadian Institute of Chartered Accountants, whereby all costs associated with the exploration and development of petroleum and natural gas reserves are capitalized. Capitalized costs include acquisition costs, geological and geophysical costs, lease rentals on non-producing lands, development costs of both productive and unproductive wells, plant and equipment costs, and administration costs reasonably allocable to these activities. Gains or losses arising from the disposition of petroleum and natural gas properties are accounted for as a reduction to the capitalized costs unless this treatment would result in a significant change in the rate of depletion in which case the gain or loss would be reported in earnings.

Capitalized costs are depleted and depreciated using the unit-of-production method, based on total proved petroleum and natural gas reserves, before royalties, as determined by independent consulting engineers. For purposes of the depletion and depreciation calculation, natural gas reserves are converted to a petroleum equivalent unit of measure. The carrying values of undeveloped properties are excluded from the depletion and depreciation calculation.

The Corporation applies a ceiling test to capitalized costs, net of accumulated depletion and depreciation, to ensure these do not exceed the estimated undiscounted value of future net revenues from proved petroleum and natural gas reserves, based on year end prices and costs, adjusted for estimated future general and administrative expenses, abandonment and restoration costs, financing costs and income taxes. The Corporation periodically reviews the costs associated with undeveloped properties to determine whether the costs will be recoverable. An impairment allowance is made if the results of the review indicate an impairment has occurred.

An estimate of future abandonment and restoration costs is provided for using the unit-of-production method. Costs are estimated based on current regulations, expenditures, technology and industry standards. Actual abandonment and restoration costs are charged to the accumulated provision account.

The amounts recorded for depletion and depreciation of capital assets and the provision for future abandonment and restoration costs are based on estimates. The cost ceiling is based on such factors as estimated proved reserves, production rates, petroleum and natural gas prices and future costs. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of future periods could be material.

A substantial portion of the Corporation's exploration and development activities are conducted jointly with others. The financial statements reflect only the Corporation's proportionate interests in such activities.

(b) Financial instruments:

Financial instruments are used to manage exposures related to petroleum and natural gas prices and to interest rates. They are not used for trading or speculative purposes. Gains or losses arising from the petroleum and natural gas instruments are included in the gross revenue of the respective commodity. Costs or benefits under the interest rate swap are recorded as interest expense.

2. Going Concern:

These financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that the Corporation will continue in operation for the foreseeable future and will be able to realize its assets and discharge its obligations in the normal course of operations.

At December 31, 1997 the Corporation had a working capital deficiency of $17,753,183, a shareholders' deficiency of $2,147,757 and had incurred a net loss of $11,315,705 for the year then ended. Furthermore, the Corporation was in violation of certain covenants with its primary lender (see note 5).

The application of the going concern concept is dependent upon the successful completion of the arrangement agreement (see note 11) and the Corporation's ability to generate future profitable operations and to receive the continued financial support of its lender and other creditors to enable the Corporation to meet its obligations as they become due. Management has taken steps to restructure the Corporation and in this regard believes the going concern assumption to be appropriate for these financial statements. If the going concern assumption were not appropriate for these financial statements, adjustments might be necessary to the carrying value of assets and liabilities, reported revenues and expenses and the balance sheet classifications used.

3. **Deferred charges:**

Deferred charges represent costs relating to the issue of convertible bonds and are being amortized over the five-year term of the bonds.

	1997	1996
Costs	$ 176,063	$ 152,298
Accumulated amortization	(43,089)	(7,629)
	$ 132,974	$ 144,669

4. **Capital assets:**

1997	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties	$ 38,108,672	$ 24,437,921	$ 13,670,751
Production equipment and facilities	14,125,878	8,185,288	5,940,590
	$ 52,234,550	$ 32,623,209	$ 19,611,341
1996			
Petroleum and natural gas properties	$ 38,978,170	$ 15,569,622	$ 23,408,548
Production equipment and facilities	13,422,874	4,609,028	8,813,846
	$ 52,401,044	$ 20,178,650	$ 32,222,394

As a result of a ceiling test calculation which was performed effective December 31, 1997, it was determined that the net book value of the Corporation's petroleum and natural gas properties exceeded the net recoverable amount calculated under the full cost accounting guideline and a write-down of $7,200,000 was recorded as additional depletion and depreciation. The Corporation also recorded a write-down of $1,800,000 at September 30, 1997. The prices used in the ceiling test calculation at December 31, 1997 were $21.54/Bbl for conventional crude oil, $13.49/Bbl for heavy oil, and $1.85/Mcf for natural gas. The price for conventional crude oil represented an average of current prices; had the Corporation used the December 31, 1997 price of approximately $22.80/Bbl a write-down totaling approximately $4,000,000 would have resulted. The ceiling test is a cost recovery test and is not intended to result in an estimate of fair market value.

For the year ended December 31, 1997, overhead applicable to acquisition, development and exploration activities in the amount of approximately $312,000 (years ended December 31, 1996 - $593,000; 1995 - $687,000; 1994 - $492,000; 1993 - $349,000) was capitalized. The depletion calculation has excluded $1,122,000 (1996 - $5,160,000) representing the lower of cost and fair market value of undeveloped land.

As at December 31, 1997, the estimated deferred future abandonment and restoration costs to be accrued over the remaining proved reserves totaled approximately $1,100,000.

5. **Long-term debt:**

	1997	1996
Bank debt	$ 12,411,000	$ 13,300,000
Convertible bonds	3,000,000	3,000,000
Demand loan	2,000,000	2,000,000
Capital lease	308,414	433,388
	17,719,414	18,733,388
Current portion of bank debt	(12,411,000)	–
Current portion of demand loan	(2,000,000)	(2,000,000)
Current portion of capital lease	(141,033)	(125,981)
	$ 3,167,381	$ 16,607,407

5. Long-term debt (continued):

(a) Bank debt:

At December 31, 1997, the Corporation had a $13,000,000 revolving demand credit facility of which $11,111,000 was outstanding at December 31, 1997 with a lender (Alberta Treasury Branches) which bears interest at the lender's prime rate plus ½% per annum and is secured by certain petroleum and natural gas properties, a general charge over all other assets, a general assignment of production reserves and a debenture for $12,000,000.

At December 31, 1997, the Corporation also had a specific demand loan for $1,300,000 bearing interest at prime plus 1% per annum.

At December 31, 1997 the Corporation was in non-compliance with certain covenants stipulated in its banking agreement. Discussions regarding the continuation of the credit facility have been on going between the Corporation and Alberta Treasury Branches. However, the bank has indicated that it is not prepared to grant a waiver on the covenants until its review following a successful completion of the arrangement agreement (see note 11).

The fair value of the bank debt approximated its carrying value at December 31, 1997.

(b) Convertible bonds:

Effective October 1, 1996, the Corporation issued 9% convertible bonds which mature and are redeemable on October 1, 2001. The bonds are convertible by the holders thereof into Common Shares of the Corporation after October 1, 1997 based on a conversion price which shall be the greater of $3.00 per Common Share or the average trading price of the Common Shares determined over the 60 day period preceding the date of notice adjusted for the maximum discount currently permitted under the bylaws by The Alberta Stock Exchange. The bonds are unsecured and are subordinated to the revolving demand credit facility. In addition, the Corporation has agreed not to create or permit any further indebtedness, with the exception of bank indebtedness, in priority to the interest of the bondholders.

The fair value of the convertible bonds at December 31, 1997 approximated their carrying value.

(c) Capital lease:

The Corporation is subject to a capital lease relating to a gas compressor. The capital cost of the compressor totaling $644,000 is included in production equipment and facilities and the related accumulated amortization as at December 31, 1997 totaled $162,530 (December 31, 1996 - $104,830). The lease bears an implicit rate of interest of approximately 11.3% per annum and expires July 1, 1999. Minimum payments under the capital lease are as follows:

1998	$	180,195
1999		186,741
		366,936
Less interest		(58,522)
	$	308,414

(d) Demand loan:

At December 31, 1997, the Corporation had in place a $2,000,000 unsecured demand loan from a director, with interest based on Eurocredit rates (January 1, 1998 - 6.05%).

6. Share capital:

(a) Authorized:

(i) An unlimited number of Preferred Shares, issuable in series.

(ii) An unlimited number of Common Shares, without nominal or par value.

(iii) An unlimited number of voting convertible Incentive Shares, issuable in series.

6. **Share capital (continued):**

(b) Common Shares issued:

	1997		1996	
	Number	Amount	Number	Amount
Common Shares, beginning of year	90,318,194	$ 21,982,811	84,118,194	$ 20,417,708
Shares repurchased under Normal Course Issuer Bid	(67,300)	(15,900)	–	–
Shares issued under a flow-through share agreement, net of issue costs	–	(16,393)	6,200,000	1,475,103
Reduction in stated capital	–	(16,401,817)	–	–
Share consolidation	(81,225,804)	–	–	–
Common Shares	9,025,090	$ 5,458,701	90,318,194	$ 21,892,811

(i) At a special shareholders' meeting held November 18, 1997, a 10 for 1 share rollback was approved. Additionally, the stated share capital was reduced by $16,401,817 representing the accumulated deficit as at September 30, 1997.

(ii) During the year ended December 31, 1996, the Corporation completed a flow-through private placement of 6,200,000 shares for gross proceeds of $1,550,000. Under the terms of the agreement, the Corporation renounced the tax benefit associated with $1,550,000 of capital costs effective December 31, 1996. Each share also carried a warrant, which allowed the holder to purchase one additional Common Share at $0.30 prior to December 31, 1997. These warrants expired unexercised.

(iii) During February 1998 the Corporation issued 196,251 Flow-through Common Shares at $0.80 per share for total cash consideration of $157,000.

(iv) During February 1998 the Corporation canceled 115,000 Common Shares.

(c) Stock options:

At December 31, 1997, the Corporation had outstanding options to issue 619,826 Common Shares (December 31, 1996 - 642,044; 1995 - 627,044) to directors, officers, employees and former management. Options outstanding at December 31, 1997 to acquire Common Shares of the Corporation are exercisable at prices ranging from $2.20 to $3.00 per share and expire at various times until August 12, 2002.

(d) Per share amounts:

Per share and option amounts have been restated to reflect the 10 for 1 share rollback. The weighted average number of basic shares outstanding during the year ended December 31, 1997 was 9,027,302 (years ended December 31, 1996 - 8,567,666; 1995 - 7,709,183; 1994 - 5,457,346; 1993 - 4,341,781). Common Share options, warrants and conversion of the convertible bond issue are anti-dilutive.

(e) Shareholder Rights Protection Plan:

The shareholders approved a Shareholder Rights Protection Plan Agreement (the "Plan") on July 4, 1994. The Plan replaces a previous shareholders' rights plan approved at a Special General Annual Meeting of Shareholders held on July 12, 1990. The Plan will remain in force for a period of ten years, subject to shareholder ratification at the annual meeting immediately following the fifth anniversary of the Plan.

7. **Income taxes:**

At December 31, 1997, the Corporation had approximately $39,000,000 of resource and other unused tax pools available to offset future taxable income. Of these amounts, $596,000 are streamed against income from certain properties. Petroleum and natural gas properties with a net book value of approximately $2,800,000 have no cost for income tax purposes.

7. **Income taxes (continued):**

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory rate of 44.7% (1996 and 1995 - 44.6%; 1994 and 1993 - 44.3%) to the loss before income taxes. The reasons for the differences are as follows:

	Years ended December 31,				
	1997	1996	1995	1994	1993
Loss before taxes	$ (11,285,705)	$ (2,892,716)	$ (6,997,630)	$ (204,848)	$ (671,854)
Expected income tax recovery	$ (5,037,000)	$ (1,293,000)	$ (3,121,000)	$ (90,700)	$ (297,600)
Effect on taxes of:					
Unrecorded benefit of current year's loss	4,168,000	852,000	2,854,000	22,200	135,600
Crown royalties	778,000	773,000	639,000	408,900	238,800
Resource allowance	(509,000)	(503,000)	(499,000)	(402,900)	(133,300)
Non tax base depletion	672,000	169,000	167,000	148,400	72,900
ARTC	(96,000)	(66,000)	(131,000)	(137,900)	(50,500)
Capital Tax	30,000	62,300	127,500	86,000	34,000
Freehold mineral taxes	19,000	63,000	81,000	45,100	32,200
Other	5,000	5,000	10,000	7,000	1,900
Current income taxes	$ 30,000	$ 62,300	$ 127,500	$ 86,000	$ 34,000

8. **Related party transactions:**

(a) Based on shareholder approval received at its most recent Annual General Meeting on July 30, 1997, the Corporation terminated the Corporate and Investment Management Agreement with Alberta FutureVest Corporation ("AFVC"), the management company controlled by a former officer and former director. Fees in connection with the agreement while it was in effect were determined as the greater of $5,000 per month or 5% of defined net operating income of the Corporation. For the seven months ended July 1997, the Corporation had received a reduction in the rate to 4%.

In addition, the agreement provided for the payment of an additional 15% of all subcontracted corporate and financial management and technical management services provided by the management company plus a royalty interest in connection with acquisitions of new properties and the drilling of new wells subsequent to December 31, 1989. The 15% charge was waived by AFVC for 1997. The Corporation entered into a two-year agreement effective January 1, 1996 with AFVC to rent certain office furniture, equipment and computer hardware and software. This agreement was bought out concurrent with the termination of the Corporate and Investment Management Agreement.

Until the termination of the Corporate and Investment Management Agreement, AFVC was a related party. Transactions with AFVC as a related party were as follows:

(i) Fees paid by the Corporation to AFVC in connection with the Termination Agreement totaled direct costs of $186,000 and indirect costs of $309,000. Indirect costs represent costs where the Corporation was obligated to pay third parties on AFVC's behalf. In addition, the Corporation purchased capital assets from AFVC for $194,000;

(ii) Fees paid during the year ended December 31, 1997 pursuant to the Corporate and Investment Management Agreement totaled $158,415 (years ended December 31, 1996 - $538,667; 1995 - $574,054; 1994 - $379,747; 1993 - $305,024);

(iii) During the year ended 1997, the Corporation paid rental charges for office furniture and equipment, and computer hardware and software under its agreement with AFVC totaling $88,970 (years ended December 31, 1996 - $538,667; 1995 - $325,173; 1994 - $74,705; 1993 - $58,292). The rental charge represents a cost recovery to AFVC;

(iv) AFVC owns a 2% gross overriding royalty on substantially all of the Corporation's properties. The royalty will not apply to new lands acquired by the Corporation subsequent to the termination of the Corporate and Investment Management Agreement; and

(iv) In May 1997, the Corporation closed a property swap with two private companies managed by AFVC. The values of the properties exchanged, as verified by independent third parties, was $1,100,000 (based on proved plus 50% probable reserves discounted at 15%).

8. **Related party transactions (continued):**

(b) During the period ended July 31, 1997, the Corporation leased office space from a company owned by a former director at a cost of $75,112 (years ended December 31, 1996 - $119,601; 1995 - $124,402; 1994 - $101,423; 1993 - $91,107). The amount of rent paid reflects the Corporation's proportionate share of actual rental costs incurred by the other company.

(c) During the period ended July 31, 1997, the Corporation paid $28,300 (December 31, 1996 - $81,000; 1995 - $130,000) for legal services to a law firm controlled by the former Corporate Secretary. During the year ended December 31, 1997, the Corporation paid no fees (December 31, 1996 - $41,900; 1995 - $44,800) for services to the law firm in which the former Chief Financial Officer is a member.

9. **Reorganization expenses:**

Reorganization expenses reflect costs incurred to restructure the Corporation. These costs primarily comprised the following:

(a) the July 1997 Termination Agreement with AFVC (see note 8); and

(b) severance and employment costs associated with restructuring the Corporation.

10. **Financial instruments:**

(a) Hedging activities:

The Corporation entered into financial instrument contracts to mitigate its exposure to fluctuations in oil and natural gas prices, foreign exchange rates and interest rates. Gains or losses from these activities are reported as adjustments to the related revenue or expense accounts as they are settled. During the year ended December 31, 1997, the Corporation had a net loss of $599,500 under these contracts (net loss for years ended December 31, 1996 - $2,111,000; 1995 - $16,000; 1994 - nil; 1993 - nil). The following contracts are in effect subsequent to December 31, 1997:

(i) one long-term oil price swap agreement expiring November 2003. The price and volume parameters are adjusted annually from the current 126 BOPD at $24.45/Bbl (Cdn) to 67 BOPD at $28.86/Bbl (Cdn) in the year 2003. Current settlement of this contract would result in a gain of $6,000.

(ii) one interest rate swap fixing the Company's interest rate at 7.02% on a notional principal of $3.4 million at December 31, 1997. Current settlement of this contract would result in a loss of $190,000.

(b) Credit Risk:

A substantial portion of the Corporation's accounts receivable are with customers and joint venture partners in the petroleum and natural gas industry and are subject to normal industry credit risk. Purchasers of the Corporation's natural gas, crude oil and natural gas liquids are subject to an internal credit review to minimize the risk of non-payment.

The Corporation is also exposed to credit risk associated with possible non-performance by counterparties to the interest rate swap agreement. The Corporation believes these risks to be minimal as the counterparties are major financial institutions which have at least an AA credit rating as determined by recognized credit rating agencies.

(c) Fair Values:

The fair values of the Corporation's cash, accounts receivable and accounts payable approximated their carrying values as at December 31, 1997.

11. **Subsequent events:**

Effective December 30, 1997 the Corporation entered into an arrangement agreement with three private companies (the "Companies") whereby the Corporation will acquire all of the issued and outstanding shares of the Companies through the issuance of Common Shares of the Corporation. Under the arrangement agreement, the Common Shares of the Corporation will be consolidated on a one for three basis and in turn, the common shares of the Companies will be exchanged on a one for one basis with the Common Shares of the Corporation.

As two of the Companies share common management and together will hold the largest portion of the Corporation's issued shares after completion of the arrangement agreement, this business combination will be accounted for as a reverse takeover.

This transaction is expected to close on or about April 10, 1998 and is subject to both regulatory and shareholder approval.

In March 1998 the Corporation, through a wholly owned subsidiary, entered into an agreement with a financial intermediary to raise up to $10.175 million ($9.565 million net of commission) by issuance of special warrants on a best efforts basis (3.7 million special warrants at $2.75 per warrant). Subject to closing the arrangement agreement by April 30, 1998, each common share of the subsidiary to be issued on the exercise of the special warrants shall be exchanged for one share of AOG. If the arrangement agreement does not close by April 30, 1998 the special warrants will be repurchased for their issue price and canceled.

In the event the arrangement does not close by May 1, 1998, AOG is required to pay termination fees in the aggregate amount of $600,000 to three officers of the Corporation. In addition, if the arrangement agreement fails to close for certain specified reasons, AOG is obligated to pay $100,000 to the Companies.

CORPORATE INFORMATION

BOARD OF DIRECTORS

Kenneth L. McNeill
Calgary, Alberta

Mark D. Behrman
Calgary, Alberta

John A. Brussa
Calgary, Alberta

M. Bruce Chernoff
Calgary, Alberta

Dr. Urs Wehinger
Zürich, Switzerland

Peter B. Whiteway, P. Geol.
Calgary, Alberta

OFFICERS

Kenneth L. McNeill
President and
Chief Executive Officer

Mark D. Behrman
Vice-President Finance and
Chief Financial Officer

M. Brent Gough, P. Eng.
Vice-President, Engineering

Alan F. Williams, P. Geol.
Vice-President, Exploration

STOCKHOLDER INFORMATION

The shares of Alberta Oil and Gas Petroleum Corp. are listed on the Alberta Stock Exchange for trading under the symbol AOC. At December 31, 1997 the number of shares issued and outstanding was 9,025,090

CORPORATE ADDRESS

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Calgary, Alberta T2P 3J4
Phone: (403) 269-3779
Fax: (403) 265-6970

BANKER

Alberta Treasury Branches
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Calgary, Alberta T2P 1B9

TRANSFER AGENT AND REGISTRAR

CIBC Mellon Trust Company
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Calgary, Alberta T2P 2Z1

AUDITORS

KPMG
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Calgary, Alberta T2P 4B9

INDEPENDENT ENGINEERS

McDaniel & Associates Consultants Ltd.
2200, 255 – 5th Avenue SW
Calgary, Alberta T2P 3G6

LEGAL COUNSEL

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Calgary, Alberta T2P 2Y3

Burnet Duckworth & Palmer
1400, 350 – 7th Avenue SW
Calgary, Alberta T2P 3N9

ABBREVIATIONS

ARTC	Alberta Royalty Tax Credit
Bbl	barrel
Bbls/d	barrels per day
Bcf	billion cubic feet
BOE	barrels of oil equivalent wherein natural gas is equated to oil using 10 Mcf = 1 barrel of oil
BOE/D	barrels of oil equivalent per day
BOPD	barrels of oil per day
Mbbls	thousand barrels
MBOE	thousand barrels of oil equivalent
Mcf	thousand cubic feet
Mcf/d	thousand cubic feet per day
Mmcf	million cubic feet
Mmcf/d	million cubic feet per day
MSTB	thousand stock tank barrels
NGLs	natural gas liquids
WTI	West Texas Intermediate

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